Rathbone Greenbank Dynamic Growth Portfolio

Quarterly investment update, October to end December 2022

Rathbones
Look forward

Hot topics – 'Top-down' (market and macroeconomic)

Exit, followed by inflation. US Federal Reserve (Fed) hikes are no longer transitory. The Fed raised interest rates rapidly in 2022 as it chased after runaway inflation. The benchmark US rate jumped from 0.25% at the start of the year to 4.5% by its end, the sharpest one-year US hike fest since the early 1980s. Inflation started falling in the second half of the year, but it's still very high, both in the US and the rest of the world. So, the big question is: how much further will the Fed - and the other central banks – go with tightening? Inflation at between 7% and 11%, depending on your locale, is a long way from the 2% targets. Central bankers will want to see inflation shrinking undeniably before they ease off. However, they, more than anyone, know that it takes between one and two years for the full effect of a rate movement to hit businesses and households. That means the American economy is still digesting the first 25-basis-point rise of March 2022. There's another four percentage points coming down the pipe. Investors sniff that the Fed must have to halt soon before it overdoes its tightening (we think it has already). Yet every time bonds and stocks rally in anticipation of a 'pause', the Fed is quick to talk tough, battering prices back down. It's confusing and it is a major cause of the volatility in both bond and stock markets in recent months. We think the Fed won't hike much more from here, despite its rhetoric, yet we think forecasts of rate cuts in 2023 are unlikely. Inflation should continue to fall steadily from here, but it will plateau higher than central bankers' targets. Meanwhile, the risk of recession in the US, Europe and the world is very high. It should be shallow but looking at the economic data and the tightening yet to be felt, a downturn seems inevitable. Hopefully the Fed sees sense.

Back to the cycle. Since 2008 we haven't really had an economic cycle. Covid-19 interrupted our societies, but it wasn't at all like any past economic boom/bust cycle. For the past 14 years the global economy has pottered on in a strangely muffled state. We still had news and events and scares and surprises, but throughout it all the economy seemed smoothed. Zero interest rate policy would do that for you. Money was cheap and it flowed to all sorts of places in the great scrounge for yield. It meant that virtually anyone could borrow some cash at a generous rate to paper over some shortfalls between income and expenses. There wasn't much impetus for tough decisions about spending. Those days are over, both for people and for businesses. After many years of being little more than a bogeyman, recession is now looming large over the world. Governments, companies and households will have some hard decisions to make. Companies must make it very difficult for their customers to switch to a cheaper rival or dispense with their products all together. Otherwise they will be toast. We have been reviewing our investments using this litmus test: are they the best value option? And are they making solid profit margins that allow them the flexibility to reinvest in themselves and ride out difficult times? We want to own resilient businesses as we enter what is shaping up to be bumpy 2023.

Covid Nero. China, the 21st century's riddle, wrapped up in a mystery, inside an enigma, is playing up to its part. After three solid years of a strict zero-Covid policy, Chinese citizens had had enough. An unusual rash of large protests erupted across the country, complaining about harsh lockdowns keeping millions shut up at home (or in factories) to avoid Covid from spreading. The unrest tarnished President Xi Jinping's afterglow of getting bestowed an unprecedented third term at the party conference late last year. Whether bowing to popular opinion, economic concerns, or both, in December the Chinese leadership made a sharp about-turn and completely dismantled its stringent testing regime and social restrictions. Cases soared. We were surprised by just how swiftly China reopened – it went from zero to 60 quicker than a Tesla. The reawakening of one of the world's largest markets after several years' curtailment will have big implications for the global economy, although this too will be an enigma for some months yet. Will it spark an increase in demand for petrol, gas and other natural resources? If so, it could complicate the descent of inflation. It will definitely boost Chinese restaurants, cafes, theatres and other services that have been battered by stop-start lockdowns. If our own re-opening is anything to go by, retailers could also benefit. After a long stretch of isolation, people enjoy letting loose. A pick-up in Chinese economic growth could be a blessing for all of us, as it would counteract tough times in the West and perhaps even reduce jingoism and simmering tensions in the South China Sea. As long as inflation remains anchored, that is.

Portfolio activity

Key purchases/additions	Key sales/trims
Zebra Technologies (new purchase)	US Bancorp (sale)
Huntington Bancshares (new purchase)	ASML (trim)
Japan Government 0.1% 2023 (addition)	Linde (trim)
UK Treasury 0.125% Index-Linked Gilt 2031 (addition)	Aptiv (trim)
Advanced Drainage Systems (addition)	

Source: Rathbones

With interest rates marching higher all around the world, yields on bonds obviously increased as well over the quarter. For many years bonds were often, bluntly, return-free risks. Yields were so low that there was no real return accruing to the holder. There was precious little cash flowing back to bondholders in coupons and there was a lot of risk of capital loss if interest rates rose from record lows (which came to fruition), particularly for bonds that matured in five, 10, 20 years plus. This is no longer the case.

Therefore, we have been buying bonds. We added to the **UK Treasury 4.25% 2032**, the US dollar-denominated **Asian Development Bank 1.5% Senior 2031** and the Australian dollar-denominated **New South Wales Treasury 2.5% 2032**. We have locked in the currency exchange for the Australian bonds, so we will not lose out if sterling recovers (nor benefit if sterling weakens further). We also bought a small amount of the **UK Treasury 0.125% Index-Linked Gilt 2031**, whose coupons and capital value increase in line with RPI inflation, because it briefly became much cheaper relative to conventional UK government bonds during the October market ructions.

The belief that a US Federal Reserve (Fed) pause is just over the rainbow has weakened the dollar considerably as many investors have moved their money out of the US and into riskier assets and nations. From its peak in late September to the end of the year, the greenback sank 9.3% relative to a basket of major currencies. Against the pound specifically, the dollar dropped about 11% over the same period. This dollar weakness helped emerging market stocks rally significantly into the end of the year. Europe had a stonking run as well and even the UK recovered. This is, effectively, a 'risk-on' trade. It came at a strange time, in our view, and we haven't leapt onto this bandwagon. There was also a marked buying of gold – typically a 'risk-off' trade. About 10% higher over the quarter, the gold price continued rising in early January to $1,870, approaching its peak of $2,050 from March 2022.

It was a tough 2022 for the Bank of Japan (BoJ). For years it has tried to jumpstart inflation to no avail. It finally got there halfway through last year, with inflation breaking through the 2.0% level. By year end it was 4.0%. Unlike other countries, Japan has kept its interest rate extremely low throughout to ensure inflation beds in – it has battled deflation (falling prices) for most of the 21st Century. The BoJ had committed to keeping its 10-year government bond yield at an ultra-low level of between -0.25% and 0.25%. It did this by buying and selling mindboggling amounts of bonds to manipulate the price and therefore the yield. This is a tough task at the best of times; it's nigh on impossible when the rest of the developed world's bonds yield between 2% and 3.5%. We have exposure to Japanese yen, which tends to rise in risk-off markets. During the quarter we added some short-dated **Japan Government 0.1% 2023** bonds to maintain this exposure with minimal sensitivity to the change in interest rates. This position benefited as the BoJ widened is targeted band for the 10-year yield to 0.50% and -0.50%, and the yen jumped 3.5% against the pound on the day.

We traded one US main street lender for another in November. We sold down long-time holding **US Bancorp** and bought the smaller (but still very big) **Huntington Bancshares**. Based in Ohio, it has 1,000 branches spread across the Midwest, with Colorado and some eastern states in the mix as well. Its retail banking pitch is skewed to those who prefer in-person banking, and it scores highly in customer satisfaction. It is trying to parley that into cross-selling, especially of investment products. Huntington also has a strong business and commercial banking operation, with a growing speciality in supporting vets and dentists. Despite its down-home feel, Huntington is no luddite, sporting the top-rated mobile app among its regional bank peers. Less than 1% of its loans are to oil and gas businesses and it has a strong community spirit. Huntington has earmarked $40 billion over five years for lower-cost loans and mortgages to disadvantaged people with poor credit ratings, as well as to invest in underserved communities. The plan is to boost the wealth and vibrancy of poorer areas by offering a helping hand to get businesses off the ground and help people get a secure home. If they are successful it's good for the economy, good for the neighbourhood and good for a lender's business. It just makes sense.

We bought Illinois-based inventory management business **Zebra Technologies**. The company combines RFID (radio frequency identification) technology with cloud-based computing to help its customers better track and monitor stock and equipment. This could be knowing exactly how many widgets are in a retailer's warehouse, or letting a doctor swiftly know what has been administered to a hospital patient in the last 24 hours. Zebra sells to many different industries, from utilities and energy through to manufacturers and hotels. Where it really comes into its own though is in the analytics tools that it has developed. The insights gleaned from RFID tracking can save businesses vast amounts of money and spot inefficiencies and opportunities. We often talk about how much digital investment we believe is coming in the next decade or more as companies drag themselves into the 21st Century. Zebra should benefit.

Portfolio activity (continued)

We trimmed **ASML**, the Dutch designer of high-end commercial computer chip printers, after a recent rally. We used the cash to add to wastewater pipe manufacturer (and the largest plastics recycler in North America) **Advanced Drainage Systems** and American high-end wealth manager and private bank **First Republic** and heart valve maker **Edwards Lifesciences**, whose share prices have been weaker.

We added to our **Put Spread** structured product, which protects us against the first 25% of any fall in the US stock market. These options are effectively an insurance policy on our US stock portfolio. We pay an upfront premium in return for the right to 'sell' a given value of the S&P 500 Index at a pre-agreed level.

Spotlight

In this quarter, the spotlight is on our **DSM** and **Badger Meter** holdings.

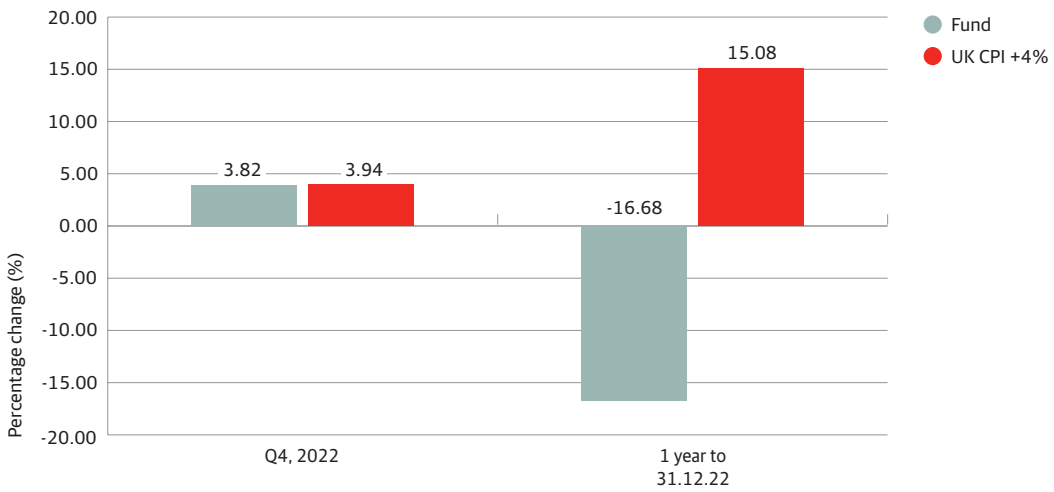
DSM

- DSM is a Dutch company operating in a number of diversified markets related to health, speciality nutrition and bioscience providing products such as dietary supplements, animal feed, probiotics, vitamins and food enzymes
- DSM has successfully undergone a multi-year strategic transition away from commodity chemicals via a mix of disposals and acquisitions towards a focused nutrition business which is expected to command high sales and growth as the trend towards healthier and more sustainable diets continues
- Particularly with its speciality nutrition and vitamins products, DSM has the ability to push through price increases to boost margins and it has strong cash conversation for a growing business
- As a global supplier of dietary products, such as vitamins and omegas, its products help to improve the nutrition and health of both people and animals – and DSM has a deep-rooted commitment to bring affordable, available and aspirational nutritious foods to middle-and low-income segments of society too through long-standing partnerships with organisations such as the United Nations World Food Programme (WFP)
- DSM has a unique pipeline of products that help improve the environment, including Clean Cow, an animal feed additive that cuts methane emissions from livestock by 30% and Delvo Plant, an enzyme solution for improving the taste, texture, and nutrition of plant-based dairy alternatives

Badger Meter

- Badger Meter is a North American industrial company focused on water metering solutions such as flow measurement, leakage detection and water quality and control, serving mainly US water utilities and municipalities
- Badger Meter helps customers optimise the delivery and use of water through actionable intelligence which maximises their revenue and reduces waste – this is vital as more of us shift to 'smart' cities and a more interconnected and digital infrastructure
- It enjoys steady replacement demand and a high and stable market share which has been gained through a strong brand and long-term customer relationships – water companies are very sticky and new entrants have significant barriers to entry
- Water stress and security is a huge environmental problem and by using Badger Meter's highly accurate metering and analytics solutions, customers could save up to five billion gallons of water and avoid over 7,850 tons of CO_2 annually
- Badger Meter's products also help to conserve resources, for example, it uses recycled material to make its bronze metering products and its operations which have zero emissions and zero water discharge

Fund performance



Performance (based on 'S-class' shares).
Net of expenses and tax. Net income reinvested.

Data source: FE fundinfo

Discrete annual performance					
Year to:	**End Dec 2018**	**End Dec 2019**	**End Dec 2020**	**End Dec 2021**	**End Dec 2022**
Fund	–	–	–	–	-16.68%
UK CPI +4%	+6.39%	+5.45%	+4.40%	+9.35%	+15.08%

Price performance based upon single price (mid). Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment.

Top performers (%)		
Holding	**Performance**	**Contribution**
Jungheinrich	+31.22	+0.31
Dexcom	+30.48	+0.26
DSV Panalpina	+23.47	+0.26
AIA	+23.01	+0.25
Johnson Controls	+21.37	+0.19

Bottom performers (%)		
Holding	**Performance**	**Contribution**
Generac	-46.53	-0.60
Advanced Drainage Systems	-37.30	-0.54
Edwards Lifesciences	-15.37	-0.20
Nidec	-14.48	-0.11
First Republic Bank of San Francisco	-13.43	-0.14

Note: Top and bottom performers are taken from the list of all holdings of 0.25% and above of the portfolio.
Performance and contribution data shown above is based on unhedged GBP capital returns.

Source: Rathbones

The final quarter of the tumultuous year that was 2022 was a more positive one for markets with major equity indices rising and bond yields falling (prices rising). The weakening of inflation data in the US gave investors increasing levels of comfort that we have seen the peak in inflation and perhaps the US Federal Reserve (Fed) feel closer to the point at which their job is done when it comes to hiking rates. In this backdrop it will come as no surprise that equities were the chief contributor to portfolio returns over the quarter, with European equities having the largest positive impact. Though 2022 was largely a challenging macroeconomic environment for the materials handling and warehouse sector with ongoing supply chain disruptions; workforce challenges and inflation, in the final quarter of year European logistic companies **Jungheinrich** and **DSV Panalpina** showed significant strength and resilience despite this. Jungheinrich reported solid third quarter results, beating analyst consensus after orders were higher than expected and DSV Panalpina announced strong cash flows and upgraded EBIT guidance for the year. In the US, **Johnson Controls**, provider of smart, healthy and sustainable buildings solutions, benefited from strong demand across its product segments especially HVAC and controls.

The first three quarters of 2022 was a period of significant US dollar strength, which meant that our hedging of the US dollar back to sterling was a relative headwind. However, that tide turned meaningfully in Q4 as we saw the exchange rate move from around 1.12 at the end of Q3 to around 1.21 at the end of the year. This resulted in our currency hedging materially protecting the gains from our US assets given the 8% fall in the value of the US dollar against sterling. Of course, this was not the whole story as the bottom of the currency pairing was around 1.03 in Asia overnight trading at the end of September, and the recovery did reach 1.24 before tailing off a touch into the Christmas and new year period. This is just over a 20% move in sterling bottom-to-top over one quarter. Having the hedging in place certainly allowed us much better participation in the recovery in US equities in Q4.

Fund performance (continued)

Generac, the US standby-power company, detracted from performance after it reported weaker than expected results and cut full year sales guidance. Although they had mid-teens net sales growth, residential business product sales came under pressure which lowered production and profit margins. However, longer-term demand should remain robust by elevated power outages due to natural disasters such as hurricanes. **Advanced Drainage Systems** also had a disappointing end to the year, after management announced a lowering of revenue guidance for fiscal year 2023. They pointed to slowdowns in isolated pockets of the business in certain geographies. However, again, as inflationary pressures ease this year, we have confidence the business has significant tailwinds behind it with its product portfolio of stormwater management solutions and water pipes.

Asset allocation ranges

Liquidity	Equity-type risk	Diversifiers
10% to 50%	20% to 60%	0% to 50%

Asset allocation change and strategy

There were no significant changes during the quarter.

Asset allocation split	30.09.22	31.12.22	% Change		12 month change	
Liquid assets	17.90%	17.67%	-0.23%	▼	-0.29%	▼
Equity-type risk	74.87%	77.63%	2.76%	▲	1.10%	▲
Diversifiers	7.23%	4.70%	-2.53%	▼	-0.81%	▼
	100.00%	100.00%				

Asset class split	30.09.22	31.12.22	% Change		12 month change	
Equities	70.30%	73.17%	2.87%	▲	0.32%	▲
Index-linked bonds	1.42%	1.34%	-0.08%	▼	-0.29%	▼
Conventional government bonds	4.95%	5.07%	0.12%	▲	0.57%	▲
Corporate bonds	10.30%	8.62%	-1.68%	▼	2.05%	▲
Emerging market debt	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Private equity	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Alternative investment strategies	6.57%	4.70%	-1.87%	▼	-0.81%	▼
Property	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Commodities	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Cash	6.46%	7.10%	0.64%	▲	-1.84%	▼
	100.00%	100.00%				

Asset allocation (continued)

Sustainable category split	30.09.22	31.12.22	% Change		12 month change	
Decent work	12.86%	13.64%	0.78%	▲	-0.13%	▼
Resource efficiency	9.57%	9.69%	0.12%	▲	-1.00%	▼
Habitats and ecosystems	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Inclusive economies	4.61%	6.06%	1.45%	▲	4.75%	▲
Energy and climate	19.11%	18.56%	-0.55%	▼	1.99%	▲
Health and wellbeing	15.74%	17.26%	1.52%	▲	2.12%	▲
Resilient institutions	5.14%	5.18%	0.04%	▲	-0.95%	▼
Innovation and infrastructure	19.94%	17.81%	-2.13%	▼	-4.13%	▼
Diversifiers	6.57%	4.70%	-1.87%	▼	-0.81%	▼
Cash	6.46%	7.10%	0.64%	▲	-1.84%	▼
	100.00%	100.00%				

The 'resilient institutions' category includes government bonds.

Investment outlook

As 2023 dawns, most people expect another extremely tough year. While falling, inflation is still very high, squeezing everyone's living standards. The war between Russia and Ukraine grinds on, complicating the supply of everything from oil and gas to food and metals. While the outlook is grim, we should remember the lesson of 2022: no one knows what tomorrow will bring. And when everyone is expecting the worst, there's a greater chance that things won't be as bad as they feared.

A year ago, the prevailing belief was that the global economy would disintegrate if American interest rates rose above 2% or so. The US benchmark rate should be 5% by early February and while economies are slowing, the world is far from economic Armageddon. The UK and the Eurozone are likely already in the midst of a downturn because they are at the epicentre of the energy crisis caused by the Ukraine war. While the European recession won't necessarily be very deep, it is expected to be prolonged – especially in the UK, where it may even last all year. The US is still holding up, but it seems destined to slow over the coming 18 months as the economic handbrake that is all those rate increases starts to be felt. Exactly how much is the big question. Post-pandemic economic data is hard to decipher because of the stark demand and supply changes in all sorts of markets from labour to cars and raw materials. We will be watching our investments carefully as the year progresses.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

Rathbones
Look forward

Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment.

8180.01.23